XLIV. Introduction.

A. There are a wide variety of Constitution arrangements that can be shown to affect the performance of government.

B. We have already discussed several of ways in which institutions can affect one important aspect of political processes. Several institutional arrangements will increase the likelihood that political processes have an equilibrium: bicameralism, various agenda control restrictions, etc.

C. Today, I want to discuss three other constitutional factors that can affect the performance of democratic decision making.

XLV. The Generality Principle

A. In *Politics by Principle not Interest* (1998) Buchanan and Congleton argue that rules which constrain government to provide services more or less uniformly can sharply reduce both rent-seeking expenditures and usefully increase the stability of governmental policies.

B. The intuition behind their argument can be illustrated with the following game matrix which resembles a PD game but which is interpreted in a quite different manner in their analysis.

	Coalition B Transfer to B	Do Not Transfer to B
Transfer to A Coalition A	-1, -1	1, -2
Do Not Transfer to A	-2, 1	0, 0

D. The individual cells of the game represent different policies or social states that can be chosen by which ever party comes to power.

  i. Note that Coalition a will chose the lower left hand cell if it comes to power and Coalition B will choose the upper right hand cell.

  ii. That is to say, coalitional democracy has a predisposition to transfer wealth from those outside the dominant coalition to those inside the dominant coalition.

E. If these coalitions are somewhat unstable, then as power shifted back and forth between them, policy outcomes would oscillate between the lower left hand outcomes and the upper right hand outcomes.

  i. Note that if this rotation was fairly even, that the average payoff to being able to discriminate would be -0.5 for each coalition, e. g. (0.5)(1 - 2).

  ii. Moreover, each coalition has in incentive to spend considerable resources to try to avoid being the minority coalition (their personal wealth increases by 3 units if they can move from the minority to the majority position), thus considerable majoritarian rent seeking expenditures might take place

F. Together, these two effects suggest that each coalition would benefit if somehow they could escape from this game.

  i. One possibility might be that they would try to eliminate future elections.

G. Another possibility of greater interest to Buchanan and Congleton is that they could adopt a constitutional rule which "eliminates the off diagonals possibilities" by forbidding discriminatory transfers.

  i. Note that in this case, both coalitions would face choices along "the diagonal."

  ii. And, moreover, note that each group now prefers the same policy. (Here no transfers.)

  iii. Stability exists, and the particular form of stability is Pareto Superior to the original setting where the constitution allows discriminatory transfers to take place.

H. (In their book, BC apply their analysis to a broad range of policies to show that this "generality" line of argument can be applied to a wide range of modern public policies.)

XLVI. Federalism

A. There are many economic an political cases that can be made to support Federalism as a competitive form of government. Consider the following one based on reducing rent-seeking and other types of political conflict.

B. A simple rent seeking game: Suppose that ethnic group "A's" probability of securing a transfer, T, via the contest of interest is approximately equal to the ratio of their efforts, E^A, to all others, E^O, $P^A = E^A / (E^A + E^O)$.

  i. Suppose further that the cost of each unit of political effort is simply C. In this case, A's expected net benefit, N^e, from engaging in political activity is simply the expected transfer less the cost of the effort undertaken.

$$N^e = P^A T - E^A C \tag{2}$$

  ii. Differentiating with respect to E^A and setting the result equal to zero, allows (ethnic) group A's political profit maximizing investment in rent-seeking to be characterized as:

$$[- E^O / (E^A + E^O)^2]T - C = 0$$

or

$$E^A = -E^O + [TE^O/C]^{1/2} \qquad (3)$$

iii. Now, consider the very tractable equilibrium that emerges if there are K-1 other equally well organized and effective groups participating in the political influence game of interest. At the symmetric equilibrium all groups make the same investment in rent-seeking activities, so $E^o = (K-1) E^A$. Substituting into equation 3 and solving for E, allows the Nash equilibrium political effort of each group to be determined:

$$E = (1-1/K) T / KC \qquad (4.1)$$

and total rent-seeking cost, **R**, across all K groups is:

$$\mathbf{R} = KEC = (1-1/K) T \qquad (4.2)$$

C. Note that both single group investments (4.1) and the total amount invested among all groups (4.2) increase as the political prize (T) increases. Note also that as the number of groups, K, gets large, the total amount invested approaches T, the total value of the transfer sought. That is to say, a multinational state in which ethnic or nationalist groups seek transfers or favorable regulations from government tends to waste more and more scarce economic resources in political conflict.

D. To assess the merits of Federalism as a device to reduce rent seeking by ethnic or other natural groups, consider first the extreme perfectly competitive case in which the cost of moving between local governmental jurisdictions is zero. That is to say, suppose people can costlessly relocate from one political jurisdiction to another, e. g. M = 0.

  i. Note that anyone who finds himself to be a member of an unfavored group would simply relocate to another community where his own ethnic group is favored or at least not relatively disadvantaged.

  ii. Members of "favored' groups that are not equally favored in their current locations would migrate to the locality where they might best profit from local discrimination.

  iii. Thus, Tiebout-type competitive equilibrium in a federal multinational state with local favoritism is characterized by many essentially *ethnically pure* local governments producing various local government services at least cost. Obviously, favoritism can have only very limited effects on the distribution of wealth within such an equilibrium.

    a. Complete sorting implies that *all* bureaucratic services will be monopolized by a dominant ethnic group.

    b. However, complete sorting also implies that *all* those seeking services will be members of the same ethnic group.

E. Now consider, the level of resources that will be invested in political conflict within a country with L equal sized autonomous local governments. Suppose that their are N^L residents in each district and that moving between districts costs M^L while moving between countries costs M^C, with $M^C > M^L$.

  i. The greatest transfer that can be financed from a single local or national citizen is his opportunity cost of moving: M^L for local governments and M^C for national governments. Consequently, the maximal transfer that can be undertaken by a local government is $M^L N^L$.

  ii. Suppose that K local interest groups participate in a maximal local rent-seeking for this transfer which has the same format as the national game previously analyzed. From equation 4.2 above, we know that local political conflict will consume :

$$\mathbf{R}^L = (1-1/K)\ M^L N^L \qquad (5)$$

    a. In the perfectly competitive federal environment, each community is homogeneous so K = 1, and no ethnic rent-seeking takes place.

    b. In the case of interest here, the number of ethnic rivals in a local jurisdiction, K^L, is greater than 1, but is smaller than the number of groups in the country, K^C, as a whole to the extent that some sorting of groups has taken place under federalism.

    c. Given, $K^L < K^C$, it is clear that fewer resource will be invested in political conflict locally than nationally whenever the same political prize is at issue.

  iii. On the other hand, national transfers can be much greater than that of any single local jurisdiction because national population is greater than local population and, perhaps most significantly, moving costs are greater.

  iv. Maximal national transfers can be represented as $LN^L M^C$. Resources devoted to political conflict to receive such a maximal national transfer would be:

$$\mathbf{R}^C = (1-1/K^C)\ LN^L M^C \qquad (6)$$

  v. This is clearly much greater than the resources devoted to political conflict in any single local jurisdiction, and, of greater relevance for the present analysis, exceeds that of all L jurisdictions combined. The latter can be written as:

$$\mathbf{LR}^L = (1-1/K^L)\ LN^L M^L \qquad (7)$$

  vi. Comparing equations 6 and 7, it is clearly the case that ethnic based political conflict is smaller in a decentralized federal system for two reasons. First, greater mobility implies a smaller political prize to be competed for, $M^C > M^L$. Second, greater ethnic homogeneity implies that fewer competitors in the political game, $K^C \geq K^L$. Together these imply that maximal rent seeking costs fall unambiguously as programs are moved from the central government to local governments.

XLVII. Cultural Norms

A. Cultural norms can similarly affect the kind of policies that will be adopted in a society insofar as those norms affect preferences over public policies.

B. For example, if transfers are believed to be a form of theft, then many will who might receive them will vote against such polices on moral grounds.

  i. (We do observe farmers voting against farm programs and educators employed by the state voting in favor of vouchers.)

  ii. Penalties imposed on drug sales versus other "economic" crimes provide evidence that "sin" is often subject to very stringent taxes.

  iii. Norms of Honesty and a Work Ethic naturally reduces monitoring costs in politics as well as in the private sector.